Key Proposals for the UK's Vertical Block Exemption Successor

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The proposals include certain notable changes, while also mirroring the current UK framework and the European Commission's planned approach in many respects.

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The UK Competition and Markets Authority (CMA) has proposed replacing the retained Vertical Agreements Block Exemption Regulation (Retained VABER), which has applied in the UK following the country's departure from the EU and will expire on 31 May 2022, with a UK Vertical Agreements Block Exemption Order (UK VABEO). The CMA's proposals include a number of changes intended to reflect evolving market conditions and enforcement practice, and to widen the CMA's existing powers.

Concurrently, the European Commission is consulting on the draft revised Vertical Block Exemption Regulation (VBER) and Vertical Guidelines, planned to enter into force in the EU at the same time as UK VABEO.

This blog post provides an overview of the key similarities and differences between (i) Retained VABER and the proposed UK VABEO, and (ii) the proposed UK VABEO and the draft EU VBER.

What is the vertical agreements block exemption?

Vertical agreements are those entered into between businesses operating at different levels of the production or distribution chain (e.g., manufacturers and wholesalers or retailers). Vertical agreements that meet the following conditions benefit from an exemption from the application of Chapter I of the Competition Act 1998, which prohibits anticompetitive agreements:

1. The market share of each party to the vertical agreement in its relevant market does not exceed 30%.
2. The vertical agreement does not contain any 'hardcore' restrictions.

Agreements that do not fulfil these conditions do not automatically infringe competition law — rather, they are subject to a case-by-case assessment.

This general framework is common between Retained VABER, the proposed UK VABEO, and the EU VBER.

What is staying the same?

The proposed UK VABEO does not modify the following aspects of the current regulation:

- **Market share thresholds.** The CMA recommends retaining the condition that vertical agreements will only be block-exempt if the parties' respective market share is 30% or less. A 30% market share has long been regarded as a threshold under which agreements are unlikely to have harmful effects on competition.
- **Resale price maintenance (RPM).** RPM entails directly or indirectly restricting a distributor's or retailer's ability to determine its sale price. In Europe, RPM has long been treated as a restriction of competition 'by object' for several reasons, including that it restricts competition both among distributors/retailers and between manufacturers and distributors/retailers, and it tends to increase the prices paid by consumers for a particular brand. RPM has been a significant area of CMA antitrust enforcement, with several recent cases across a range of industries resulting not only in financial penalties for the parties involved, but also warning letters to other industry participants. Indeed, over 95% of all 239 warning letters issued by the CMA in relation to competition matters in the past five years relate to RPM.[i] The CMA's RPM enforcement activity has also been recently upheld by the Competition Appeal Tribunal. It is therefore unsurprising that the CMA recommends retaining RPM as a 'hardcore' restriction.
- **Non-compete clauses.** The CMA proposes that non-compete obligations with a duration that is indefinite or exceeds five years should remain excluded from the block exemption. Parties are not precluded from agreeing to non-compete obligations lasting more than five years, but an individual assessment would be required to determine whether such obligations infringe competition law. The CMA is also not proposing to change the treatment of post-term non-compete obligations (which are currently excluded from the block exemption).

What is changing?

The CMA's proposals introduce the following changes:

- **Online sales restrictions.** The CMA considers that the treatment of certain online sales restrictions can be relaxed given that online retail is now sufficiently established, and the case law (including the English courts' jurisprudence) provides sufficient safeguards. The CMA's decisional practice has gradually reflected the growth of online retail, with previously pronounced distinctions between online and in-store shopping becoming increasingly blurred. Indeed, recent CMA market definition analysis in a merger context considered the two channels within the same product market. Against this background, the CMA recommends that the following restrictions not be treated as 'hardcore' under UK VABEO:
    - Dual pricing (charging a distributor higher prices for products to be sold online than offline)
    - Imposing criteria for online sales that are not overall equivalent to those imposed in brick-and-mortar stores in a selective distribution system
- **Territorial and customer restrictions.** To give businesses more flexibility in designing their distribution systems, the CMA proposes to introduce three new exceptions to the otherwise unmodified 'hardcore' territorial and customer restrictions. The exceptions would permit:
    - The combination of exclusive and selective distribution systems in the same or different territories

- The allocation of a territory to more than one 'exclusive' distributor
- Greater protection for members of selective distribution systems against sales from outside the territory to unauthorised distributors in the territory

The CMA considers that no further changes to the treatment of territorial and customer restrictions as 'hardcore' restrictions are warranted at this stage, in order to support consumer choice across the UK and while th practical implications of the Northern Ireland Protocol and the integration with the EU single market in Northern Ireland are not yet fully understood.

- **Parity obligations/most favoured nation clauses.** The use of most favoured nation clauses across sales channels (in particular online) has been the subject of increased scrutiny by competition authorities across Europe. The CMA proposes that 'wide' most favoured nation clauses — or 'indirect sales channel parity obligations', which prevent suppliers from offering a product or service on better terms on any other sales channel — should be a 'hardcore' restriction. This change reflects concerns that such obligations soften competition between indirect sales channels and reduce the incentives of intermediaries to compete.
- **Cancellation in individual cases.** The CMA intends to widen its powers to withdraw the block exemption. Under Retained VABER, the block exemption may be withdrawn if parallel networks of similar vertical restraints cover more than 50% of a relevant market. However, the CMA plans to widen its powers considerably so it may cancel the block exemption for any agreement it considers not to be exempt. Whilst the CMA considers that this provision is likely only to be used in exceptional circumstances, it introduces considerable scope for legal uncertainty, in apparent dissonance with the rationale for the block exemption.
- **Obligation to provide information.** The CMA proposes that UK VABEO should impose an obligation on parties to vertical agreements to provide the CMA with information within 10 working days of being requested to do so. Failure to provide this information without reasonable excuse would result in cancellation of the block exemption for the agreement(s) in question. This power would allow the CMA to double-check the parties' self-assessment, adding to the legal uncertainty that would be created by the possibility of withdrawing the block exemption in individual cases. This power would also be a new addition to the CMA's wide-ranging information-gathering powers, which have been used extensively and gave rise to heightened enforcement action in areas such as merger control.

What are the parallels with the EU's proposed approach?

As part of its review of competition rules on vertical restraints, the European Commission is consulting on the draft revised VBER and Vertical Guidelines.[ii] The European Commission is proposing to take a similar approach to the CMA with respect to:

- The removal of the block exemption for 'wide' parity clauses
- The introduction of exceptions for shared exclusivity and greater protection for members of selective distribution systems against sales by unauthorised distributors located within the selective distribution network
- The removal of dual pricing and lack of equivalence of criteria imposed on online sales and brick-and-mortar stores as 'hardcore' restrictions

However, while the CMA is proposing to extend the dual distribution exception (so it applies equally to manufacturers, wholesalers, and importers), the European Commission is proposing to tighten it. The Commission's tiered proposal for dealing with dual distribution is aimed at addressing the horizontal concerns that may arise when a supplier competes directly with its distributors, notably in relation to information exchange. By contrast, the CMA considers that this is best left for self-assessment by businesses, who could use information barriers to address such concerns.

What are the key implications?

The CMA's proposals have important business and regulatory implications, including the following.

- **A familiar framework.** Stakeholders will likely welcome the retention of the vertical block exemption in a familiar format. The proposed substantive changes are incremental compared to Retained VABEI and not unexpected in view of developments over the past decade, including in competition enforcement and case law.
- **Limited divergence with the EU.** Overall, the CMA's proposals are largely consistent with the equivalent EU proposals. However, scope for divergence remains and is visible in the proposed treatment of dual distribution, which is more nuanced under the EU proposals. UK businesses engaging in dual distribution in the EU — or with effects in the EU — will need to navigate those nuances.
- **An expansion of the CMA's powers.** Perhaps the proposed changes with the most significant practical implications are the considerably wider powers that the CMA envisages for itself. The current trend o heightened enforcement activity on the CMA's part suggests that the CMA is unlikely to leave such new powers unused. While fines have not been proposed as a potential penalty (e.g., for failure to provide infor mation without reasonable excuse), the CMA has separate powers to impose significant financial penalties should an agreement for which the block exemption is withdrawn be found to infringe competition law.

Endnotes

[i] https://www.gov.uk/government/publications/competition-law-warning-and-advisory-letters-register/warning-letters-issued-by-the-cma.

[ii] Please refer to the EU Distribution Rules Under Review Antitrust Client Briefing (9 July 2021) at https://www.lw.com/thoughtLeadership/eu-distribution-rules-under-review for further details.

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